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The Economics of Small States; Observations from Scotland - a Comment

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The historical perspective provided by John Kay in his article presents a compelling rationale for re-thinking what a state is and what it should do. The production relationships and consumption patterns that characterise today's interconnected global economy mean that sub-national regions or cities are more natural units within which to analyse socioeconomic development and the policies to promote it. Indeed, in Europe and elsewhere the globalization of the last twenty years has been associated with considerable devolution of policy-making powers from national to sub-national levels in search of an 'economic dividend' and/or the closing of a 'democratic deficit' (Morgan, 2002; Diaz-Serrano and Rodríguez-Pose, 2015). A result is that the powers once typically associated with the nation state are now distributed in different ways in different places, and increasingly are also exercised in new ways that reflect more porous boundaries between public and private sectors.

While Kay draws on observations from Scotland, many of the arguments could also be illustrated and supported by experience in other places. The Basque Country in northern Spain is an interesting case for at least two reasons. First, it illustrates particularly well the complexity of relationships between different levels of government that are responding to and at the same time shaping new conceptions of state. Secondly, it is a deeply studied case in terms of industrial and business policies. The Basques arguably enjoy greater policy autonomy than any other sub-national region in Europe, but their story is not a simple one of powers transferred from a large state to a small one. The reality is that Basque policy-making takes place in an extremely complex multi-level scenario. Three sub-regional provinces have tax-raising powers, alongside considerable policy competences, and they transfer funding for regional government activities. A transfer also goes to the Spanish government to support the limited areas where they retain policy competences, and local municipal authorities play a key role too in many areas, in particular around the development of the three main Basque cities.

A key point in Kay's article is that government competences should adapt (and are adapting) to the scale that best suits specific policy challenges, so that "we can envisage multiple layers of government operating within a single local area". This is very much the case in the Basque Country, and a lesson from experience there is that the boundaries between which policies work best at different levels are by no means clear-cut. Finding the right mix is a practical question that is highly context specific, but one that also cannot be separated easily from the emotional attachment to territory that often lies behind a desire

for greater policy autonomy. Science and technology policy provides a good illustration. Basque regional autonomy has contributed to dynamism and agility in the development of innovative policies that have supported clear regional priorities, in part because different agents have pulled together behind the 'project' of the territory. Yet there are scale issues too that make certain regional priorities difficult to sustain in times of crisis and imply that certain infrastructure-intensive projects are more suited to national or European support. The exploitation of synergies across places is also a key consideration, especially if 'lock-in' is to be avoided. Therefore it is not just policy autonomy at regional level that is required but also the means and will to co-ordinate policy with other levels and with other regions. The policy-driven transformation of the Basque economy over the last forty years both illustrates the interplay between different policy levels and supports Kay's argument that "some of the major winners have been small states whose economies have been able to pursue their strengths without the paralysis created by conflicts between large, established interests". A cornerstone of this transformation was the commitment of the newly autonomous government to support an 'industrial reconversion', at a time in the 1980s when it was unfashionable to talk about industrial policy. While much of the finance for the reconversion came from central government, it was regional and provincial government leaders that worked closely with Basque business leaders to ensure a real commitment to change and support for the progressive up-grading of the competitiveness of Basque industry. For example, as pioneers of cluster policy in the 1990s, a culture of strong public-private partnership was fostered to address specific areas of weakness and to build on strengths.

The gradual and focused evolution of industrial and business policies that have supported a largely successful transformation of Basque industry also provokes reflections on the strategic implications for small states of Kay's observation that economic success today is "predicated on the development of relatively narrow competitive advantages in firms and groups of firms". Such arguments are in line with the logic behind so-called smart specialisation strategies (Foray, 2014; Morgan, 2013), and they fit with currently-popular arguments for strategic approaches to fostering territorial competitiveness (Valdalisio and Wilson, 2015). These approaches urge territories to prioritise relatively narrow areas on which to focus research and innovation support, but stress that this prioritization should not be the result of government planning. Rather, it should result from new forms of private-public interaction that enable the knowledge embedded within a wide set of agents in the territory to shape the strategic process and facilitate an alignment of investments in research and innovation.

The Basque experience demonstrates above all that effective economic competitiveness policy goes hand-in-hand with a coherent strategy. Policy supporting the competitiveness upgrading of the Basque economy has been developed in the framework of a long-term and flexible strategy. Private-public partnership, and in particular the presence of government leaders capable of engaging business and building networks, has been critical to this strategy. Indeed, a key lesson for considering the new, multi-level constellations of state highlighted by Kay is that the desirable level of policy autonomy can't be divorced from the level of policy capability (including quality of institutions and stability), or from the desire to exercise that autonomy.

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